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Surveys and Speculations

Three centuries of corporate governance in the United Kingdom

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Abstract

As articulated by Adam Smith, one of the central issues facing companies is that managers will not run the business in the interests of its owners and will misuse resources. This ultimately has a detrimental consequence for the wealth of the nation. This survey reviews the nature and evolution of the corporate governance of UK public companies over the past 300 years. It makes two principal arguments. First, because the separation of ownership and control was one of the rationales for the introduction of the corporate form, we should not be surprised that corporate ownership has generally been diffuse. Second, over time, the way in which owners ensure that managers act in their interests has gradually changed from a system in which shareholders monitored and exercised voice to one where there was more reliance on external forces and exiting ownership.

KEYWORDS

agency costs, control, corporate governance, ownership, shareholders, UK

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According to legal scholars, the modern corporation or company has five defining legal characteristics that distinguish it from the partnership form of business organization.[1] One of these characteristics is that it has a managerial hierarchy, that is, only designated officers of the company can enter binding contracts or release debts on behalf of the business. These officers are the company's governors, directors, or managers. As recognized by Adam Smith, these officers:

> being the managers rather of other's people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own…Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.[2]

This separation of ownership and control and its associated incentive problems creates what are known as agency costs.[3] These costs include those incurred to ensure that the incentives of directors are aligned with those of owners and those where there is a welfare loss due to directors taking decisions that do not benefit owners. Thus, corporate governance is concerned with how the latter cost can be minimized or, phrased another way, how a society ensures that controllers of a company act in the interests of owners.

How has this problem identified by Adam Smith evolved, and how has it been addressed in the United Kingdom over the past three centuries? The aim of this article is to answer these two questions. There are three main areas that scholars have investigated and debated with regards to the history of corporate governance in the United Kingdom.

The first major issue is when the corporation, with its five key interrelated legal features of separate legal personality, limited liability, transferable shares, investor ownership, and a managerial hierarchy, emerged in the United Kingdom. The company form bearing these five legal characteristics only becomes commonplace after freedom of incorporation with limited liability is introduced in 1855 and rolled out to every industry in 1862.

The second major issue that scholars have debated is when diffuse corporate ownership emerged in the United Kingdom. Diffuse ownership is where there is no one shareholder with a large share of votes in the company and shares in the company are widely distributed. Various time periods have been proposed as to when corporate ownership became diffuse, but this survey will suggest that diffuse ownership has been commonplace from at least 1720.

This separation of ownership from control raises the third major issue that scholars have wrestled with: how the interests of the shareholders and managers of British companies have been aligned. Over the past three centuries, the United Kingdom has gone from a situation where the responsibility for solving the problem rested on shareholders and relied on dividends, local knowledge, and directors as delegated monitors to one where there is greater emphasis on disclosure, legal protection, and the ability to exit ownership via takeovers or selling shares.

[1] See Kraakman et al., *The anatomy*, p. 5. For the interested reader, there is considerable debate as to the key difference between partnerships and corporations: see Freeman et al., *Shareholder democracies*; Hansmann et al., 'Law'; Harris, *Industrializing English law*; idem, 'A new understanding'; Turner, 'The development'.

[2] Smith, *The wealth of nations*, Book V, p. 330.

[3] Jensen and Meckling, 'Theory of the firm'; Fama and Jensen, 'Separation of ownership and control'.

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Why is corporate governance important? The basic task of directors its to combine the various inputs of the firm such as labour and capital to produce outputs in the most efficient manner. Poor management will mean that firms are producing below their production possibility frontier. Thus, corporate governance is vitally important for the productivity of individual companies, and if there are systemic issues with corporate governance, then this will translate into sluggish productivity growth at the national level.

A second reason why corporate governance is important is that its quality is an important determinant of the supply of finance from financial markets and institutions to companies.[4] One reason given by some scholars as to why the Victorian and Edwardian capital market channelled so much investment overseas rather than to UK industries is that corporate governance at the time was deficient.[5]

Why is it important to have an historical perspective on corporate governance? In other words, why should scholars outside economic history be interested in this topic? As well as learning lessons from our ancestors, there may be institutions formed or decisions made in the distant past which shape corporate governance today. The persistence of these institutions or decisions therefore needs to be comprehended.[6]

The rest of this article is structured as follows. The next section explores the evolution of the corporate form since 1720. The third section examines the question as to when diffuse ownership emerged. The fourth section then discusses how the agency problem has been addressed over time. The final section provides a summary and highlights a future research agenda.

I | THE EVOLUTION OF THE CORPORATE FORM

The company form has evolved to have the following interrelated legal features: separate legal personality, limited liability, transferable shares, investor ownership, and a managerial hierarchy.[7] The foundational feature is the legal fiction that a group of individuals with a common interest can act as a body with legal personality. During the sixteenth century, various mercantilist companies which had monopolies of long-distance trade were granted corporate status by the Crown, e.g., the Muscovy Company (established 1555); the Levant Company (established 1581), and the East India Company (established 1600). These companies had a separate legal personality, a managerial hierarchy, and transferable shares. Investor ownership, whereby someone could invest capital in a company without participating in the operations or management of the business, first came in 1617 when the East India Company raised capital from 1000 investors for its voyage to the Indies

[4] Shleifer and Vishny, 'A survey'; La Porta et al., 'Legal determinants'.

[5] Cottrell, *Industrial finance*, p. 54; Kennedy, *Industrial structure*, p. 127.

[6] See, for example, La Porta et al., 'Law and finance'; La Porta et al., 'Corporate ownership'; eisdem, 'Economic consequences'; Mahoney, 'The common law'; Stulz and Williamson, 'Culture'; Musacchio and Turner, 'Does the law and finance'.

[7] At this stage, we need to explain the difference between a corporation and a company because, in UK parlance, 'company' is used rather than 'corporation'. The explanation for this is that, as we will see later in this section, for over a century companies existed in Britain which were unincorporated, that is, they were not recognized as companies in the sense that they did not have a separate legal personality. This meant that such companies faced a risk of being declared illegal when they interacted with the increasingly conservative judiciary. Indeed, by the early nineteenth century, solicitors in England could not assure their clients that 'the deed of association he would draft at their request would be held legal in court' (Harris, *Industrializing English law*, p. 249).

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that year.[8] Limited liability was not a watershed feature of the corporation and only appeared in the nineteenth century.[9]

After the Glorious Revolution, the Bank of England (established 1694) and the South Sea Company (established 1711) were formed to help the government with its finances. In January 1720 the South Sea Company presented the government with a scheme to refinance its debt at lower interest rate. The South Sea scheme involved converting government debt for South Sea Company shares. To encourage investors to do this, the directors engineered a bubble in the company's shares.[10] The excitement around the South Sea Company spilled over into the wider market, with around 190 unincorporated companies forming in 1719–20.[11] Because this diverted funds away from the South Sea Company's scheme, the Bubble Act was passed by Parliament to outlaw these unincorporated companies.

The company, despite several claims to the contrary, was very much a creation of the state.[12] Prior to 1720, the right to grant the privilege of incorporation was chiefly that of the Crown. But Parliamentary ascendancy during the eighteenth century meant that the power to incorporate moved gradually away from the Crown so that entrepreneurs wishing to form a company now approached Parliament for a corporate charter via a private act. There were over 150 such companies incorporated between 1720 and 1825.[13] Many of these companies were canals, a sector which went through a promotion boom in the early 1790s.[14] Canals familiarized Parliamentarians with the corporate form and led to the further development of the secondary market for company shares.[15]

The Bubble Act was ineffectual. Only one prosecution took place in the eighteenth century, and many unincorporated companies were established in the 1700s.[16] What was an unincorporated company? Put simply, it was an organizational form whereby investors combined their funds into a business enterprise. The deed of settlement, which was the constitutional document that governed the affairs of an unincorporated company, permitted delegated management and a separation of ownership from control. Deeds also permitted transferable shares if trustees (in whom company assets were vested) approved the transfer. Some deeds tried to limit the liability of shareholders, but, in reality, they could only do so among themselves and not to third parties.[17] Unincorporated companies, however, did not have a separate legal personality because they were ultimately not creations of the state.[18]

[8] Cooke, *Corporation*, p. 58.

[9] Harris, 'A new understanding', claims that limited liability only becomes important or bites when long-term debt financing becomes commonplace in the late nineteenth and early twentieth century. But his view ignores the fact that companies had many important and large creditors before the advent of debenture finance, e.g., peer-to-peer loans, banks which had granted large overdrafts, trade creditors, employees, and customers.

[10] See Quinn and Turner, *Boom and bust*, pp. 25–8.

[11] Hoppit, 'The myths'.

[12] Anderson and Tollison, 'The myth of the corporation'. By way of contrast, Woodward, 'The struggle', p. 12, states that it is 'shocking how non-laissez-faire are the roots of the corporation – a quintessentially laissez-faire institution'.

[13] Freeman et al., *Shareholder democracies*.

[14] Ward, *The finance of canal building*.

[15] Harris, *Industrializing English law*, p. 100; Turner, 'The development'.

[16] Harris, *Industrializing English law*; Freeman et al., *Shareholder democracies*.

[17] Harris, *Industrializing English law*, p. 143.

[18] The situation is Scotland was somewhat different because of its civil law heritage (Freeman et al., 'Different and better?'; Acheson et al., 'Organisational flexibility').

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For Harris the unincorporated company was not a successful surrogate for the company form.[19] As a result, Parliamentary intervention was required. Although Freeman et al. suggest that this transformation was more evolutionary than revolutionary, the actions of Parliament between 1825 and 1855 were radical and had far-reaching consequences. In 1825 there was a stock market boom with some 624 companies floated.[20] Questions as to their legality resulted in 438 requests to Parliament for corporate status, with 286 of these having their own act of incorporation.[21] In 1826 Parliament would grant banks the freedom to incorporate as unlimited liability companies, and this privilege was extended to all business sectors in 1844.[22] Harris describes how radical this legislation was: 'for the first time in at least 500 years corporations could be formed without explicit, deliberated and specific State permission'.[23] Freedom to incorporate with limited liability was legislated for in 1855.[24] In between all these acts, Parliament granted corporate and limited liability status to numerous railway companies in the 1830s and 1840s.[25]

The result of this liberalization was a rapid growth in the number of companies and in the capitalization of the stock market.[26] For example, 13 years after the passage of the 1826 Act, there were 137 banks which had been incorporated in the United Kingdom.[27] Prior to the passage of the 1844 Act, there were about 720 companies chiefly in banking, insurance, canals, railways, mining, and shipping known to the London market.[28] In the 14 years after the 1855 Act, the average number of new company registrations was 445 per annum.[29] This average had grown to 3661 in the 1890s. By 1907, the total stock of registered companies was 41 651 for the United Kingdom.[30] Estimates based on the *Stock exchange official intelligence* suggest that there were just over 3500 public companies in 1900.[31] In other words, allowing for some growth in this figure, about 85 per cent of companies in 1907 were not publicly traded on a stock market.

The perhaps unexpected development that occurred with freedom to incorporate was the development of the private company, that is, companies with small numbers of shareholders who did not issue capital to the public. The framers of the various Companies Acts up to 1907 had not

[19] Harris, *Industrializing English law*.

[20] See English, *A complete view*.

[21] Harris, *Industrializing English law*, p. 143.

[22] Banking Copartnerships Act (1826), 7 Geo. IV, c.46. The Joint Stock Companies Registration and Regulation Act (1844), 7/8 Vict., c.110.

[23] Harris, *Industrializing English law*, p. 284.

[24] An Act for Limiting the Liability of Members of Certain Joint Stock Companies (1855), 18/19 Vict., c.113. This Act was repealed, but re-enacted in 1856. The re-enactment was entitled "An Act for the Incorporation and Regulation of Joint Stock Companies, and other Associations (1856), 19/20 Vict., c.47". The privilege of limited liability was extended to banks under the Joint Stock Banking Companies Act (1857), 21/22 Vict., c.49.

[25] See Campbell and Turner, 'Dispelling the myth'.

[26] On the growth of stock market capitalization, see Acheson et al., 'Rule Britannia'; Campbell et al., 'Before the cult of equity'.

[27] Turner, *Banking in crisis*, p. 39.

[28] Harris, *Industrializing English law*, p. 222.

[29] On number of incorporations in this era, see Shannon, 'The limited companies'; Harris, 'The private origins'; Todd, 'Some aspects'.

[30] Harris, 'The private origins'; Todd, 'Some aspects'. Hannah, 'A global corporate census', estimates the number of statutory and chartered companies and adds this to the number of registered companies. His estimate of the total stock of companies in 1910 is 55 474.

[31] Coyle et al., 'Law and finance'.

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anticipated this development because companies were typically viewed as large entities attracting capital from the public. Subsequently, the Companies 1907 was passed to accommodate and regulate the establishment of private companies.[32] The reasons why entrepreneurs chose this route rather than the partnership one needs much more attention from scholars as does the corporate governance arrangements of these private companies.[33] In the rest of this article, however, we will focus solely on the ownership and control of public companies.

II | WHEN DID DIFFUSE OWNERSHIP EMERGE?

An influential study, written by Adolf Berle and Gardiner Means, identified that by 1930 the ownership of the largest 200 corporations in the United States was diffuse, and that ownership had separated from control.[34] Berle and Means have shaped how legal scholars and economists have thought about the ownership of the corporation over the past century.[35] First, the common view is that ownership separated from control in US companies at some stage between 1880 and 1930, and this paradigm has dominated discussions of corporate governance in the United States ever since. This orthodoxy is not, however, without its critics, but the characterization developed by Berle and Means remains the dominant view.[36] Second, it is commonly believed that the United States was the first mover towards the separation of ownership and control, and other common law countries, such as the United Kingdom , experienced a similar transition in the latter part of the twentieth century. For example, Roe suggests that ownership did not separate from control until after 1979 and the economic reforms of the Thatcher government.[37] Cheffins, Scott, and Nyman and Silberston appear to concur with this viewpoint, suggesting that Britain in the 1970s was not yet fully characterized by the Berle and Means view of the corporation.[38] Others suggest that ownership had probably separated from control around 1950, and still others propose a date somewhere between 1930s and 1970s.[39] Foreman-Peck and Hannah, however, have argued for an extreme divorce of ownership and control by as early as 1911.[40] So, when did corporate ownership in the United Kingdom become diffuse?

Before answering this question, we need a definition of diffuse ownership. According to La Porta et al., a controlling stake is usually defined as 20 per cent of the company's voting rights. Otherwise, ownership is diffuse.[41] It is possible, however, that a board of directors could hold this

[32] Companies Act 1907, 7 Edw. 7. c. 50.

[33] For an excellent overview of this ignored part of the corporate ecosystem, see Harris, 'The private origins'. See Guinnane et al., 'Contractual freedom', for a study into the governance of these types of companies. See Bennett, 'Interpreting', on the partnership ecosystem in England and Wales in 1881.

[34] Berle and Means, *Modern corporation*.

[35] La Porta et al., 'Corporate ownership'.

[36] See Hannah, 'Divorce of ownership'; Holderness, 'Myth of diffuse ownership' and Lipartito and Morii, 'Rethinking the separation'. Cheffins and Bank, 'Myth', provides a summary of the dissenting views, but argues that the Berle and Means view remains a valid starting point for the analysis of corporate governance in the United States.

[37] Roe, 'Political preconditions'.

[38] Nyman and Silberston, 'Ownership'; Scott, 'Corporate control'; Cheffins, 'History'; idem, 'Does law matter'.

[39] Florence, *Ownership*; Coffee, 'Rise'; Franks et al., 'Ownership'.

[40] Foreman-Peck and Hannah, 'Extreme divorce'. See also Hannah, 'Divorce of ownership' and Braggion and Moore, 'Dividend policies', who concur with this view.

[41] La Porta et al., 'Law and finance'; La Porta et al., 'Corporate ownership'.

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amount of capital and co-ordinate their control of the company. In this case, although there may be many investors in the company, ownership has not fully separated from control.

Because investor ownership and a managerial hierarchy are important legal features of the company, we should expect a separation of ownership and control from its earliest days. Ownership records exist for two of the established companies in 1720. The Bank of England had 3163 shareholders in September 1720, and its directors owned about 4 per cent of its capital.[42] The East India Company had about 1850 shareholders in 1720, and its large board of directors had about 10 per cent of the company's shares, but this had risen from about 4 per cent before the 1720 bubble and fell to about 6 per cent by 1721.[43] These director ownership figures for these two companies is based on the amount of capital they owned. This overestimates the control rights in the hands of directors because the Bank of England and East India Company operated on a one-shareholder-one-vote rule.[44]

One of the new companies that was chartered by Parliament in 1720 was the London Assurance company. In September 1720 this company had 570 shareholders, and the five largest shareholders only held 9.6 per cent of the shares, with the firm's 27 directors holding 11.7 per cent. This overestimates the control concentrated in the hands of directors because London Assurance operated a graduated voting scale with a cap of four votes.[45] The other insurance company chartered in 1720 was the Royal Exchange Assurance company. It had a similar distribution of shares to and the exact same voting scheme as London Assurance.[46]

There are 78 unincorporated companies which were formed between 1720 and 1825 in Freeman et al.'s database.[47] The number of subscribers or initial shareholders is reported for 38 of these companies. On average, there are 170 subscribers. Although this suggests that ownership was dispersed among many shareholders, it does not imply that ownership was separated from control. However, 43 of the 78 unincorporated companies had provisions in their constitutions that limited the proportion of shares that any one shareholder could own. The average of this figure for these companies was 1.87 per cent, and only one company had a figure greater than 5 per cent.

There are 150 incorporated companies in Freeman et al.'s database which were formed between 1720 and 1825. A total of 131 of these companies reported subscribers or initial shareholders. On average, these companies had 134 subscribers or initial shareholders. Just under one-third of incorporated companies had an upper limit on the proportion of shares that any one shareholder could own, and the average was 6.08 per cent.

Thus, the companies formed between 1720 and 1825 appear to be chiefly characterized by diffuse ownership, and many of them deliberately separated ownership from control by limiting the number of shares one individual could own. Why did they do this? In the case of the unincorporated companies, many, if not most, had extended liability of some sort. Having dispersed ownership meant that the risk of default was spread over many owners. This was particularly important for unincorporated banks and insurance companies because a diverse ownership

[42] Carlos and Neal, 'The micro-foundations'; Mays and Shea, 'East India Company'.

[43] Mays and Shea, 'East India Company'.

[44] Bank of England Charter, 1694; Harris, *Going the distance*, p. 304.

[45] Aldous and Condorelli, 'An incomplete revolution'. Votes ranged from 5 to 9 shares (1 vote), 10–29 shares (2 votes), 30–49 shares (3 votes), and 50 or more shares (4 votes).

[46] Supple, *The Royal Exchange Assurance*, p. 72.

[47] Freeman et al., *Shareholder democracies*.

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TABLE 1 Shareholder numbers, 1850–79

	Banks (1849)	Banks (1859)	Banks (1869)	Railways (1855)	Unlimited insurance companies (1879)
Mean	361	331	495	2459	307
P75	426	396	545	2871	430
Median	246	216	293	1159	221
P25	152	134	167	671	66
Largest	1629	1393	3500	15 115	1243
N	91	94	119	50	41

Notes: *P75* 75th percentile, *P25* 25th percentile.

Sources: Banking Almanac and Yearbook, 1850, 1860 and 1870; Parliamentary Papers. Returns of the Number of Proprietors in Each Railway Company in the United Kingdom, 238, House of Commons, London, 1856; Return Relating to Joint Stock Banking and Other Companies, 246, House of Commons, 1879.

constituency provided greater assurance to policyholders, depositors, and note-holders that their institution was safe.[48]

Many of the incorporated companies were infrastructure projects such as canals, bridges, harbours, and water companies. Diffuse ownership was a way of enfranchising the many important players who had a vested and civic interest in seeing the infrastructure completed and running smoothly to the benefit of the local community. Similarly, one reason why both unincorporated and incorporated companies may have created diffuse ownership is that shareholders were incentivized to be customers and to promote the company. In other words, diffuse ownership helped create a very loyal customer base.

The first pieces of legislation that started the liberalization of incorporation law in the United Kingdom were passed in 1825 and 1826. These acts permitted banks to incorporate as long as they had unlimited shareholder liability. As can be seen from table 1, the average British bank in 1849, 1859, and 1869 had hundreds of shareholders, and shareholder numbers grew over time. Several of these banks had in excess of 1000 shareholders. Notably, many of these banks, particularly smaller ones, also restricted the proportion of shares that any individual could own, and those that did not have these provisions placed an upper limit on the number of votes that any shareholder could exercise. In other words, the constitutions of these banks deliberately engineered diffuse ownership and a separation of ownership from control.[49]

The founders of these banks clearly wanted diffuse ownership, and they did so because of unlimited liability. The belief among bankers at the time was that the more shareholders from the wealthy classes a bank had, the more secure it was, and therefore the more attractive it was to depositors and customers.[50] The founders of these banks also wanted diffuse ownership so as to create a loyal customer base. For example, it was commonplace before the 1840s for banks to take their own stock as a form of collateral for loans, and shareholders were expected to be depositors and promote the circulation of the bank's notes.[51]

[48] Acheson et al., 'Organizational flexibility'.

[49] For ownership data on these banks, see Acheson et al., 'Corporate ownership and control', tab. 1.

[50] Turner, *Banking in crisis*, p. 118.

[51] Acheson and Turner, 'Investor behaviour'.

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Insurance companies faced similar issues to banks because their shareholders also had unlimited liability, which reassured policyholders.[52] The greater the diffusion of owners for these companies, the greater the potential wealth that could be called upon in the event of the collapse of an insurance company. Notably, table 1 reveals that insurance companies had diffuse ownership, and evidence based on a small number of detailed ownership records suggests very diffuse ownership.[53]

The next major turning point in the evolution of the company in the United Kingdom was the coming of the railways in the 1830s and 1840s. The railways were unlike anything that had come before them in terms of the amount of capital they needed to raise to build a national rail network. This meant that no one owner typically had the wealth to fund a major railway company and that railway companies sought capital from many small shareholders.[54] This resulted in the expansion of the stock market and the development of regional stock exchanges where railway shares could be traded.[55] By 1848 railways were about 50 per cent of all quoted stocks and just over 70 per cent of total market capitalization.[56] This expansion of the stock market is reflected in the number of shareholders that the typical railway company had. As can be seen from table 1, the 50 major railway companies in 1855 had on average around 2500 shareholders.[57] By the 1910s, the shareholders of several railways numbered in the tens of thousands.[58]

Thus, before the 1862 Companies Act, corporate ownership was diffuse. This should not be surprising because one of the chief reasons for selecting the corporate form was to have ownership separated from control so that there could be specialization in decision-making and risk bearing. Table 2 contains various estimates of ownership concentration since the 1862 Companies Act. A direct comparison of these estimates needs to be treated with care because of various sample biases. The reader is directed to the extensive notes to the table which describe the sources and sampling techniques for each estimate.

From the first row of table 2, we can see the ownership concentration of companies which were established in the 47 years after the 1855 Act. This data reveals that the largest owner on average had 10.5 per cent of the capital and that the board of directors on average owned 13.6 per cent of capital between them.[59] Notably, many of these large owners were not necessarily involved in firm governance.[60]

As can be seen from table 2, in 1911 ownership of the largest 337 public companies was very diffuse. Aldous et al. in their study find that the ownership of the 1568 largest companies in 1911 was also diffuse, but it was more on a par with what was found for the 1855–1902 period.[61] Table 2

[52] Bogle et al., 'Why did shareholder liability disappear'.

[53] Acheson et al., 'Corporate ownership and control', table 1; Acheson et al., 'Share trading'.

[54] See Campbell and Turner, 'Dispelling the myth', for an overview of the investors during the British railway mania of the 1840s.

[55] Thomas, *The provincial stock exchanges*; Rogers et al., 'From complementary to competitive'.

[56] Acheson et al., 'Rule Britannia'.

[57] Few detailed ownership records exist for the railways. The records of the Great Western Railway in 1843 reveal that the largest shareholder owned 1.6 per cent of the capital, and the five largest shareholders owned 5.8 per cent (Acheson et al., 'Corporate ownership and control').

[58] Acheson et al., 'Independent women'.

[59] The concentration of voting rights in this sample was similar to that of capital (Acheson et al., 'Corporate ownership and control').

[60] Acheson et al., 'Active controllers or wealthy rentiers'.

[61] Aldous et al., 'Was Marshall right?'.

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TABLE 2 Ownership concentration in Britain, 1855–1995

Years	N	Owned by directors (%)		Owned by largest shareholder (%)		Source
		Mean	Median	Mean	Median	
1855–1902	575	13.6(c)	9.5(c)	10.5(c)	6.6(c)	Acheson et al.
1911	337	6.6(c)	2.5(c)	–	–	Foreman Peck and Hannah
1911	1568	17.2(c)	8.9(c)	–	–	Aldous et al.
1936	92	9.8(c)	2.9(c)	16.3(v)	9.8(v)	Florence
1951	98	6.5(c)	1.2(c)	13.0(v)	5.5(v)	Florence
1983	470	–	–	15.9(c)	–	Leech and Leahy
1990	225	12.9(c)	6.2(c)	–	–	Short and Keasey
1995	802	13.0(c)	–	18.8(c)	–	Davies et al.
1999	650	8.6 (c)	1.4 (c)	–	–	Primark Extel
2013	350	3.9 (c)	0.4 (c)	17.5(c)	13.26(c)	Acheson et al.

Notes: The reader needs to be cognizant of the biases within the above samples. The 1855–1902 sample consists of registered public companies which were established in this period (Acheson et al., 'Corporate ownership'). They therefore exclude the large public companies such as banks, utilities, and railways which had been established before then (table 1). This means that the figure above for 1855–1902 overestimates the degree of ownership concentration. The sample of 337 firms for 1911 consists of public companies which have at least £1 million of nominal issued share capital (Foreman-Peck and Hannah, 'Extreme divorce'). This sample will be biased towards the firms with the most diffuse ownership. However, the sample of 1568 firms in 1911 consists of the same 337 companies plus an additional 1231 that would have been popular with investors (Aldous et al., 'Was Marshall right'). The small samples for 1936 and 1951 potentially have the most biases of any of the samples in the table. The samples are based on English public companies, which are industrials and breweries with issued share capital in excess of £3 million in 1951 ('Florence, *Ownership*, pp.35-38). It is unclear whether this sample is comprehensive even of these sectors. It certainly is not representative of the overall stock market, because it omits large companies such as banks, insurance, transportation, oil, and gas and utility companies. About 50 per cent of the top 100 companies in 1951 came from these sectors. Florence's samples also do not contain the smaller companies that were included in the 1855–1902 and 1911 samples. The 1983 sample is a random one consisting of public companies from a wide variety of industries, with 325 coming from *The Times* 1000 largest industrial companies. The 1990 sample consists of 225 industrial companies on the London Stock Exchange official list (Short and Keasey, 'Managerial ownership'), and the 1995 sample consists of 802 non-financial companies (Davies et al., 'Ownership structure'. The 1999 sample consists of the largest (by market capitalization) 650 UK public companies. The 2013 sample is based the largest 350 companies by market capitalization traded on the London Stock Exchange (Acheson et al., 'Corporate ownership'). Abbreviations: *(c)* capital, *(v)* voting concentration.

Sources: Acheson et al., 'Corporate ownership'; Foreman-Peck and Hannah, 'Extreme divorce'; Aldous et al., 'Was Marshall right'; 'Florence, *Ownership*, pp. 196–217; Leech and Leahy, 'Ownership structure'; Short and Keasey, 'Managerial ownership'; Davies et al., 'Ownership structure'. The data for 1999 is based on author calculations from data in Primark Extel's *Major UK companies handbook*.

also reveals that ownership diffusion, as measured by the ownership of the largest shareholder, remained at levels below the 20 per cent threshold of La Porta et al. throughout the rest of the twentieth century and into the twenty-first century.

The measures of central tendency in table 2 hide the rise of the family firm with concentrated ownership. In the late 1880s there was change in the way businesses launched on the stock market.[62] Before this time, companies usually launched from scratch. That is, the business idea was conceived, the company was incorporated, and capital was raised on the stock market in short order. After the 1880s, there was a change in the type of company floating on the stock market. Private companies or partnerships which had been around for years started floating their shares on the market. These were typically family businesses seeking capital for expansion, and, to some

[62] See Cheffins, *Corporate ownership*, pp. 181–2.

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extent founders or their descendants were able to liquidate some of their stake in the business. These founders were often reluctant to accede control to new shareholders and often just issued debentures and preference shares with inferior or no voting rights attached.[63]

Brewing is a prime example of an industry where this happened. Following the successful flotation of Guinness in 1886, over 300 breweries listed on the stock market.[64] They listed to help finance the modernization of the brewing process and the purchase of additional licensed premises, and to liquidate some of the capital of the founding family. The typical brewery was closely held by the board and members of the founding family, and 40 per cent or more of their capital structure was debt. Close control was maintained chiefly via the use of preference shares and keeping the ordinary shares in the hands of the founding families.

Acheson et al. find that companies formed in the 1890s had much higher levels of ownership concentration and that founding families maintained control via preference shares. By 1911, 24.9 per cent of the top 1548 companies were family companies, and the directors of companies at the 75th percentile owned 24.1 per cent of the shares. This translates into 17.0 per cent of companies where directors owned more than one-third of the shares and 8.1 per cent of companies where directors owned 50 per cent or more of the shares. As the railway companies were merged into the big four groupings and as banks and insurance companies merged, family firms became more important on the stock market.

The separation of ownership and control had been a central rationale for the adoption of the company since 1720. But by the end of the nineteenth century, this was a less important driver of incorporation. Incorporation was now seen as a way for established businesses to partially cash out or to raise additional funds for expansion. A prominent example of the latter was J & P Coats, which was the third largest manufacturing company in the world in 1900. In 1890, needing funds to modernize their factories and build a global distribution network, Coats went public, issuing a mixture of ordinary shares, preference shares, and debentures. The family held one-third of the overall issue and maintained control of the company.[65] A famous example of an owner partially cashing out in the 1890s is Lipton, the provisions retailer and wholesaler. In 1898 Sir Thomas Lipton floated his business on the stock market, issuing both shares and bonds. Lipton did very well out of the flotation. He pocketed £2 million whilst maintaining a majority stake in the business, which he now shared with 33 000 shareholders.[66] Lipton went public because he had no heir and he wanted to raise funds for his entry into the very expensive world of international yachting.

From the nineteenth century until the 1940s, the London Stock Exchange had a rule that two-thirds of a listed company's securities had to be allotted to the public when they floated. Although the purpose of this rule was to stimulate liquidity of the market, it influenced ownership dispersion in the United Kingdom. However, the extent to which it had an effect on ownership is debated.[67]

As can be seen from table 2, ownership remained dispersed throughout the rest of the twentieth century and became more dispersed from the 1990s onwards. The privatization of large state-owned enterprises such as British Telecom and British Airways created millions of new

[63] Jeffreys, *Business organisation*, p. 268; Acheson et al., 'Corporate ownership and control'.

[64] Acheson et al., 'Happy hour'.

[65] 'Death of Mr. Archibald Coats', *Financial Times*, 13 May 1912, p. 5.

[66] *The Investors' Four Shilling Yearbook*, 1912.

[67] Hannah, 'Divorce of ownership'; Cheffins et al., 'Ownership dispersion'; Hannah and Foremen-Peck, 'Ownership dispersion'.

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shareholders in the United Kingdom and resulted in more dispersed ownership. Furthermore, from the 1960s onwards, there was a growing number of institutional investors who were taking small stakes in UK public companies.

How are we to think of this transformation from a corporate governance point of view? In many cases there was no longer a separation of ownership and control. Founders or founding families with large ownership stakes controlled companies. There was no longer an agency problem for minority shareholders.[68] Instead, there was a conflict between the insiders and minority shareholders.[69] The chief way that this manifested itself was empire building (i.e., growing the company in an inefficient manner) or a family member being in the managing director position despite there being better qualified non-family candidates.

Did ownership structure matter for firm performance? According to Demsetz and Lehn, the structure of corporate ownership should not matter for performance because the choice of ownership structure is endogenous.[70] The small number of studies which examine the relationship between ownership structure and corporate performance in the United Kingdom provide mixed results. Studies of the Victorian and Edwardian eras suggest that there is little relationship between the two.[71] However, scholars have suggested that the inefficiency of British railway companies *c*. 1900 was partially due to their very diffuse ownership.[72] Furthermore, studies of ownership in the 1980s and 1990s suggest that there were non-linear relationships between managerial ownership and firm performance in that era, but that causality from ownership to performance was difficult to demonstrate.[73]

III | HOW HAS THE CONFLICT BETWEEN BEEN OWNERS AND MANAGERS BEEN ADDRESSED?

The conflict between owners and managers requires either shareholders to incur expenditures to ensure that managers act in their interests or managers to incur bonding expenditures which commits them to acting in the best interest of shareholders. There may also be external factors acting to align managers' interests with those of shareholders.

From the owner's perspective, they have to expend resources monitoring managers. To do so, they need information on the performance of the manager and the firm. When they obtain the requisite information and a shareholder is unhappy with the performance, they can either exercise voice to try and influence the directors or exit by selling their shares.

How have owners obtained reliable information since 1720? In the eighteenth century, it was commonplace for some types of companies to give shareholders the right to inspect the company's books or to give a subset of shareholders the right to inspect company books at a general meeting.[74] It was also common to appoint shareholders as auditors.

[68] Acheson et al., 'Corporate ownership, control and firm performance'.

[69] Shleifer and Vishny, 'A survey'.

[70] Demsetz and Lehn, 'Structure of corporate ownership'.

[71] Acheson et al., 'Corporate ownership, control and firm performance'; Aldous et al., 'Was Marshall right?'; Foreman-Peck and Hannah, 'Some consequences'.

[72] Arnold and McCartney, 'Rates of return'; Crafts, Leunig, and Mulatu, 'Were British railway companies'; Mitchell, Chambers, and Crafts, 'How good was the profitability'.

[73] Leech and Leahy, 'Ownership structure'; Short and Keasey, 'Managerial ownership'; Davies et al., 'Ownership structure'.

[74] Freeman et al., *Shareholder democracies*, pp. 211–29.

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After the liberalization of company law in 1825, shareholders had less access to company account books, and fewer companies required that auditors had to be shareholders. For example, 3 per cent of companies listed in the 1890s permitted shareholders to access company books, and only 1 per cent of companies required auditors to be shareholders.[75] Access to account books fell because companies, particularly high-technology ones, wanted to protect information from competitors. The decline in access to company books and the decrease in number of companies requiring auditors to be shareholders can also be explained by the rapid growth of the United Kingdom accounting profession in the second half of the nineteenth century.[76]

Apart from companies which were incorporated by special acts of Parliament and companies which came under the purview of the 1844 Companies Act or the 1845 Companies Clauses Consolidation Act, companies were not required by law to have their accounts audited.[77] This only became a requirement with the passage of the Companies Act in 1900. This Act did not require annual financial reports to be distributed to shareholders, but from 1902, companies listed on the London Stock Exchange had to do this.[78]

Importantly, formal reporting requirements were only developed in 1868 for railways, arguably the most important corporate sector at the time.[79] Accounting historians question the usefulness of even basic financial disclosures before the reforms introduced in the Companies Act of 1948.[80] For example, net profits and total assets could be manipulated using hidden reserves, which were created by depreciating assets too quickly or deliberately undervaluing assets.[81] However, before 1914, hidden reserves were simply a consequence of a conservative approach to accounting, and they were rarely used as a way of deceiving shareholders.[82] This changed after 1914, as demonstrated in the infamous case of the Royal Mail Steam Packet Company, which in the late 1920s used hidden reserves to make the company look very profitable in a prospectus issued to investors.[83]

A further problem before the 1948 Act was that consolidation of financial accounts was not a legal requirement, which meant that companies could easily hide profits and losses, debt, and assets in subsidiaries. This only really became a problem after 1918, when subsidiaries were larger and more commonplace.[84]

The absence of credible public disclosure of the firm's financial position meant that shareholders before 1900 or even 1948 potentially faced major information asymmetries.[85] Information, however, about a firm can be communicated via its dividend policy.[86] Dividends are a credible form of information because, unlike financial accounting data, they cannot be easily manipulated,

[75] Acheson et al., 'Private contracting'.

[76] Hunt, *The development*, pp. 140–2; Watts and Zimmerman, 'Agency problems'; Baskin and Miranti, *History of corporate finance*, pp. 184–6.

[77] Hunt, *The development*, pp. 138–9.

[78] Cheffins, *Corporate ownership*, p. 95.

[79] Baskin and Miranti, *History of corporate finance*, p. 185.

[80] Marriner, 'Company financial statements'; Arnold and Matthews, 'Corporate financial disclosures'; Arnold, 'Should historians'; idem., 'Publishing your private affairs'.

[81] Marriner, 'Company financial statements'.

[82] Edwards and Boyns, 'Accounting practice'; Arnold, 'Should historians'; idem, 'Publishing your private affairs'.

[83] Davies and Bourn, 'Lord Kylsant'.

[84] Arnold, 'Should historians'.

[85] Cheffins, *Corporate ownership*, p. 110.

[86] Miller and Rock, 'Dividend policy'.

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and they must be paid out. Before the twentieth century, the dividend was in most cases the only piece of information which shareholders could trust to determine how well managers were performing.[87] Indeed, in this era, the dividend paid was the chief concern of shareholders.[88]

The news media may also have filled some of the information lacuna facing investors. However, widespread press coverage of public companies and stock markets only commenced in the mid-1840s.[89] Furthermore, not all sources were equally credible. For example, the railway press in the 1840s was anything but impartial about railway companies because of the large advertising revenue it obtained from them.[90] *The Times*, in contrast, cemented a reputation as a trustworthy source of financial and corporate information because it published several highly critical editorials at the height of the railway mania.[91] As a result, shareholders valued the financial coverage of *The Times* and demanded a lower return from companies who were covered in the financial press.[92]

Shareholders in companies up until *c*. 1900 also obtained information on managerial performance because they lived close to the companies they invested in and perhaps had direct contact with the company and its directors.[93] Studies have shown a substantial degree of local preference among a company's shareholder base in the nineteenth and early twentieth centuries.[94] For example, even among the largest railway companies *c*.1920, 40 per cent of shareholders lived within 5 miles of one of the company's stations.[95] This preference for investing in local companies was a key driver of the establishment of 29 provincial stock exchanges around the United Kingdom in the nineteenth century.[96] Notably, as this preference diminished in the first decades of the twentieth century, regional stock exchanges disappeared.

Institutional investors, such as insurance companies and investment trusts, started to move away from fixed-income securities and into company shares in a major way in the 1920s and were dominant owners in many companies by the 1950s.[97] Figure 1 shows that in 1963 individuals only owned 54 per cent of United Kingdom quoted shares in terms of value, and by 1999, this figure reached 15 per cent. Because institutional shareholders take major stakes in companies and because they devote resources to monitoring those same companies, individual shareholders then can free ride on their efforts. This free riding was given academic credence by the Efficient Market Hypothesis, which implied that all available information about a firm was reflected in a firm's share price thanks to the efforts of institutional investors.[98] A company's share price was now the only information that mattered to an individual shareholder.

[87] Baskin and Miranti, *History of corporate finance*, pp. 19, 255; Braggion and Moore, 'Dividend policies; Campbell and Turner, 'Substitutes for legal protection'; Cheffins, *Corporate ownership*, pp. 108–15 Turner et al., 'Why do firms pay dividends'.

[88] Cheffins, 'Dividends'; Jefferys, *Business organisation*, p. 409.

[89] Preda, 'The rise of the popular investor'; Taylor, 'Watchdogs or apologists'.

[90] Campbell et al., 'The role of the media'.

[91] Campbell et al., 'The role of the media'.

[92] Turner et al., 'Media coverage'.

[93] Jeffreys, *Business organisation*, pp. 409–10. See also Lowenfield, *Investment*, p. 121; Berle and Means, 'Corporations'.

[94] Acheson et al., 'Share trading'; Acheson and Turner, 'Investor behaviour'; Franks et al., 'Ownership'; Reed, *Investment in railways*; Rutterford et al., 'Individual investors'.

[95] Acheson et al., 'Independent women'.

[96] Rogers et al., 'From complementary to competitive'.

[97] Franks et al., 'Spending less time with the family'; Bogle et al., 'Capital market development'.

[98] See Fama, 'Efficient capital markets'.

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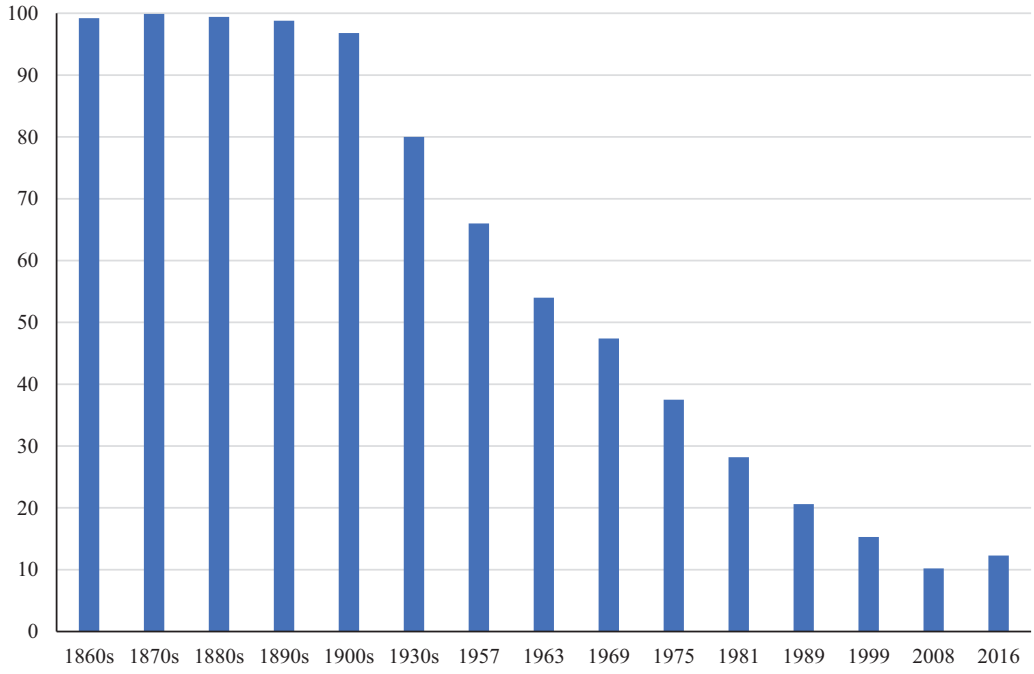

FIGURE 1 Estimates of the proportion of quoted UK shares owned by individuals (%). *Sources*: The data for the 1860s to 1900s is from Acheson et al., 'Who financed', 617. This data covers 453 companies that were incorporated and floated on the UK stock market between 1862 and 1902. The data for the 1930s is for the early 1930s and is an approximation from Cheffins, *Corporate ownership*, p. 267. The data for 1957–2016 is from Office for National Statistics, *Statistical Bulletin: Ownership of UK Quoted Shares: 2016*, Tab. 12. This data covers major listed companies in the United Kingdom.
[Colour figure can be viewed at wileyonlinelibrary.com]

If shareholders were not pleased with managerial performance, what were they able to do about it? One thing that they could do was exit their investment by selling their shares. This may have been difficult for shareholders of early companies for at least two reasons.

First, there was not a very liquid or deep capital market in the eighteenth and early nineteenth century, which made selling shares difficult. Second, many companies, especially unincorporated ones, required director approval before shares could be transferred to a new owner.[99] Although this may chiefly have been a tactic to circumvent the Bubble Act's ban on freely tradable shares, it may also have served other useful purposes.[100] For one, it may have prevented undesirable owners who were simply speculators from joining and disrupting the shareholder body. It was also a useful way of making sure that a prospective owner had sufficient wealth to cover uncalled capital or shareholder liability.[101] Interestingly, it was commonplace for companies with illiquid shares to empower directors to buy shares from those shareholders wishing to sell.[102] This permitted disgruntled, or otherwise, shareholders to exit their shareholding on demand. This practice of a

[99] Freeman et al., *Shareholder democracies*, pp. 72–5.

[100] Turner, 'The development'.

[101] Hickson and Turner, 'The trading of unlimited liability bank shares'; Turner, *Banking in crisis*, pp. 108–12.

[102] Acheson and Turner, 'The secondary market'.

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company buying its own shares was outlawed for over a century after the 1887 court case of Trevor versus Whitworth.[103]

Liquidity of the stock market increased over the nineteenth and into the twentieth century chiefly because companies grew larger, as did shareholder constituencies.[104] There is no evidence to suggest that director vetting of shares impinged upon share liquidity.[105] However, shares were illiquid by modern-day standards, and illiquidity was a risk not priced by shareholders, which means that they did not value it.[106] This is probably because many of them were buying and holding for the long run.[107] The evidence on share liquidity suggests that it was only from the early twentieth onwards that exit became a common response when shareholders were dissatisfied with managerial performance. Even as late as the 1950s and 1960s, share market illiquidity made exit difficult for dissatisfied shareholders in some industrial sectors.[108]

Another way in which shareholders can exit is via a hostile takeover. The first hostile takeover in the United Kingdom happened in 1953.[109] Thereafter, they proliferated. By 1961, around 25 per cent of the companies listed on the stock market had been taken over by other companies.[110] Why did the market for corporate control emerge when it did and not earlier? Its emergence was largely because the financial disclosures required under the 1948 Companies Act meant that potential hostile bidders could now more easily determine the true value of a company and its assets.[111] British companies attempted to impose antitakeover defences through, for example, dual-class shares. But the influence of the now-influential institutional shareholders and the London Stock Exchange put pressure on companies to expunge these defences.[112] Takeovers were here to stay. Franks and Harris examine the around 1800 takeovers in the United Kingdom between 1955 and 1985 and find that the shares of target companies gain 25–30 per cent when the merger was announced.[113] Thus, the market for corporate control helped address the agency problem.[114]

The alternative to exit is for shareholders to exercise their voice at company general meetings. How easy has it been for shareholders to do this over the past 300 years? Shareholders have always had the right to vote at general meetings. In many companies in the eighteenth century, one-share-one-vote rules did not apply. A small number of companies had one-shareholder-one-vote rules, but the vast majority capped the maximum number of votes any one shareholder could exercise.[115] Such rules empowered small shareholders vis-à-vis large shareholders and would have encouraged participation at general meetings. However, by 1883, only 23 per cent of listed companies

[103] Trevor v. Whitworth 12 App Cos. 409.

[104] Campbell et al., 'The liquidity'.

[105] Acheson and Turner, 'The secondary market'.

[106] Campbell et al., 'The liquidity'.

[107] Acheson et al., 'Share trading'.

[108] Toms and Wright, 'Corporate governance'.

[109] Franks et al., 'Spending less time with the family'; Roberts, 'Regulatory responses'.

[110] Hannah, 'Takeover bids', p. 67.

[111] Hannah, 'Takeover bids'; Franks et al., 'Spending less time with the family'.

[112] Franks et al., 'Spending less time with the family'.

[113] Franks and Harris, 'Shareholder wealth effects'.

[114] Jensen and Ruback, 'The market for corporate control'.

[115] DuBois, *The English business company*, p. 289; Freeman et al., *Shareholder democracies*, p. 148.

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had such voting mechanisms, and in the 1890s, it was very uncommon for a newly formed public company to have such a voting rule.[116]

In the eighteenth and nineteenth centuries, general meetings were sometimes more frequent than today, but overall, they were relatively poorly attended.[117] Perhaps this reflects well-run companies or, more likely, it reflects free riding by shareholders, whereby they let others bear the costs of exercising their voice. Alternatively, proxy voting, which was commonplace in the eighteenth century and almost universal by the end of the nineteenth century, meant that shareholders could exercise their voice without having to attend general meetings.[118] There is anecdotal evidence that some annual general meetings (AGMs) at the beginning of the twentieth were reasonably well attended.[119]

The poor attendance at general meetings meant that disgruntled shareholders who attended general meetings could have an outsized say regarding the performance of the company's managers. Nevertheless, they may not have had the voting power to do anything about it unless they had attracted lots of proxy votes. One potential solution to correct egregious behaviour or to address the dissatisfaction of a shareholder with the information presented by directors was to call for a committee of inspection or investigation into the affairs of the company. Such rights were not that commonplace in the eighteenth century but became more so in the nineteenth and were enshrined into law in the 1862 Companies Act.[120] These committees, which were composed of shareholders, investigated the affairs of the company, reported back to shareholders, and could recommend the removal of some or all of the directors. To establish a committee required holders of 20 per cent of issued capital to request it.[121] Despite this high hurdle, and the potential cost to shareholder members of having such a committee, they occasionally happened. However, the use of such committees declined from the 1930s. According to Rutterford and Hannah, the demise in their use coincides with the rise of institutional shareholders with their in-house committees of investigation as well as a greater use of exit by shareholders when they were disgruntled.[122]

Although monitoring and then acting on the information may have proved too costly for most small shareholders, there was always the possibility that they could delegate the monitoring of managers to boards of directors.[123] The purpose of directors in eighteenth-century companies was to run the company but also to keep a check on those with ultimate executive or operational power. In other words, directors existed to represent the interests of shareholders. Unsurprisingly, therefore, there were reasonably large shareholding requirements to become a director. In addition, to prevent capture of directors by managers, director terms were short, a substantial proportion of the board was subject to election each year, and, in a small number of cases, directors could not be immediately re-elected back on to the board.[124]

[116] Acheson et al., 'Private contracting'; Campbell and Turner, 'Substitutes for legal protection'.

[117] Freeman et al., *Shareholder democracies*, p. 171.

[118] DuBois, *The English business company*, p. 289; Acheson et al., 'Private contracting'.

[119] Rutterford, 'The shareholder voice'.

[120] Freeman et al., *Shareholder democracies*, p. 227.

[121] Companies Act (1862), 25 & 26 Vict. c.89 s. 56.

[122] Rutterford and Hannah, 'The unsung activists'.

[123] Hart, 'Corporate governance', p. 681.

[124] Freeman et al., *Shareholder democracies*, pp. 79–102.

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In their study of Victorian companies, Campbell and Turner find that individual director qualifications were ubiquitous and set at high levels relative to the size of the share issue.[125] This meant that directors had skin in the game when it came to acting as delegated monitors, and this was reflected in company performance. Campbell and Turner also find that companies with larger boards of directors performed better and surmise that this is because larger boards make it harder for managers to capture individual directors. Finally, Campbell and Turner find that ornamental directors, that is, those appointed because they were part of the aristocratic or social elite, had a negative effect on firm performance, which suggests that they were counterproductive as delegated monitors.[126]

We know much less about the independence and role of directors as delegated monitors in the twentieth century. One can speculate that there were two forces at play which reduced the effectiveness of boards of directors as delegated monitors. First, family-controlled businesses became much more common, with the result that they would have been reluctant to place outside shareholders on the board to act as delegated monitors. Second, by the 1920s, inflation would have eroded the value of directorial share qualifications, which were usually expressed in nominal terms. Indeed, the recommendation of the Cadbury Report in 1992 that the majority of the board of directors be comprised of directors who were independent of the management of the company suggests that things had moved too far away from the ideal form of the eighteenth and nineteenth centuries of the board being a delegated monitor.[127] The Cadbury recommendations became part of a voluntary code followed by listed companies, but one could question the incentives of such directors given that directorial share qualifications are a thing of the past.

Small shareholders could also delegate the monitoring of directors to institutional investors who have the incentives and means to monitor managers. The extent to which institutional investors have monitored managers and acted on the information they have gleaned and how this has changed over time is very much a subject for future scholars to explore.

As well as shareholder monitoring, managers can incur bonding expenditures, which commits them to acting in the best interests of shareholders. Bonding expenditures by company managers have taken a variety of forms over the past 300 years.

Scholars have suggested that dividends act as a bonding agent because managers cannot dissipate free cash flows and they have to go more often to the capital market, which means that they are subject to the scrutiny of investment professionals.[128] Evidence from the nineteenth and early twentieth centuries offers little support for dividends playing this role in the United Kingdp,.[129] Corporate debt can play a similar role because the commitment to paying regular interest payments means that managers cannot waste the company's free cash flow.[130] Corporate debt was not commonly used until the end of the nineteenth century, and it was mainly used in large monopolies such as railways.[131] There is, however, no research which examines the role of debt in corporate governance over the long run in the United Kingdom.

[125] Campbell and Turner, 'Substitutes for legal protection'.

[126] Grossman and Imai, 'Taking the lord's name in vain'. Grossman and Imai find something similar for British banks before 1913.

[127] *Report of the Committee on the Financial Aspects of Corporate Governance*, chaired by Sir Adrian Cadbury, 1 December 1992.

[128] Easterbrook, 'Two agency-cost explanations'.

[129] Braggion and Moore, 'Dividend policies'; Turner et al., 'Why do firms pay dividends'.

[130] Jensen and Meckling, 'Theory of the firm'.

[131] Coyle and Turner, 'Law, politics and financial development'.

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Another way in which founding managers and hence subsequent managers can commit to act in the interests of shareholders is to insert clauses in the company's articles of association or deed of settlement, which limits their ability to do certain things.[132] For example, it was common for companies to place limits on the ability of managers to take on debt. This limit on their borrowing powers prevented managers taking excess risk with the company's assets. It was also common for clauses to place limits on the ability of managers to issue new equity, which prevented small shareholders being diluted. Finally, company constitutions placed limits on self-dealing by managers by requiring them either not to profit from such transactions or to absent themselves from board votes on such matters.

Another example of a bonding mechanism is to tie executive compensation to firm performance.[133] The constitutions of companies in the eighteenth and early nineteenth centuries rarely mention such compensation, but it would have been in the gift of the company to pay its directors a bonus.[134] Companies formed in the four decades after 1862 were much more likely to mention explicitly director bonuses in their articles of association. For example, of the 505 companies in the Acheson et al. database, 172 mention the payment of bonuses to directors.[135] Bonuses were attached to dividends in 69 per cent of cases and profits in the other 31 per cent of cases. The companies that did not mention bonuses in their constitutions were, of course, free to award them at their general meetings.

There is a lacuna of information on executive incentive pay after 1900, but the fact that only 8 per cent of large UK companies in 1979 had an annual bonus scheme for their top executives suggests that executive incentive pay was uncommon in the twentieth century.[136] However, between 1979 and 1993, there was a dramatic change in the use, nature, and levels of executive bonus schemes. By 1993 almost all public companies had incentive pay schemes for executives. Following the example of the United States, executive share incentive schemes and stock options became increasingly common. The increased use of incentive pay also coincided with huge real increases in executive pay. The median pay of the top executive in all public companies rose by 149 per cent between 1980 and 1993, and for the 100 largest companies it increased by 336 per cent.[137] These huge pay increases, particularly in the newly privatized utilities, provoked a public backlash and a concern that executives had too much of an influence on the size and structure of their compensation package.[138]

In response to the public backlash, the Cadbury Report recommended that responsibility for setting a company's executive pay should rest with a remuneration committee consisting mainly of non-executive directors.[139] The Confederation of British Industry then commissioned Richard Greenbury, the CEO of Marks and Spencer at the time, and a group of leading CEOs to produce a report on executive pay. The Greenbury Report, published in 1995, suggested that remuneration needed to be sufficient to attract, retain, and motivate talented executives and that pay should be

[132] Acheson et al., 'Private contracting'; Freeman et al., *Shareholder democracies*, pp. 198–200.

[133] Eaton and Rosen, 'Agency'.

[134] Freeman et al., *Shareholder democracies*, pp. 102–4.

[135] Acheson et al., 'Private contracting'.

[136] Conyon et al., 'Taking care of business: executive compensation'.

[137] Conyon et al., 'Taking care of business: executive compensation'.

[138] Conyon, 'Directors' pay'; Conyon and Singh, 'Taking care of business'.

[139] *Report of the Committee on the Financial Aspects of Corporate Governance*, chaired by Sir Adrian Cadbury, 1 December 1992.

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connected to performance.[140] Their chief recommendation was that remuneration committees, consisting of only non-executive directors, should determine executive pay and report on their remuneration policy at AGMs. But despite Cadbury and Greenbury, executive pay remained high and disconnected from performance.

As well as bonding mechanisms and shareholder monitoring, there may have been external factors acting over the past three centuries to ensure that managers acted in the interests of shareholders. The competitiveness of a company's product or service market encourages managers not to waste corporate resources and to act in the best interests of shareholders.[141] If managers fail to do this, then firms will be outcompeted by their rivals.[142] Campbell and Turner find some evidence that competition ameliorated agency problems in the Victorian era.[143] Crafts has suggested that weak competition interacted with the separation of ownership and control to undermine Britain's productivity growth from the 1930s to the 1970s.[144] Similarly, Broadberry and Crafts argue that the growth of restrictive practices and anti-competitive behaviour in the United Kingdom in the inter-war period weakened competition in the product market, which in turn resulted in managerial underperformance and weaker productivity from the 1920s onwards.[145]

Another external constraint on managers is the legal and extralegal protection afforded to shareholders. Prior to the liberalization of incorporation law in the 1850s, companies incorporated by the Crown and Parliament had standardized shareholder protection clauses inserted into their incorporation bills. This practice was formalized in the 1845 Companies Clauses Consolidation Act (CCCA).[146] However, there was no equivalent for unincorporated companies, and because they operated in the shadow of the legal system, there was potentially little recourse for aggrieved shareholders. Rather than copy the CCCA, the 1862 Companies Act did not give shareholders much in the way of protection, and neither did the London and the various provincial stock exchanges.[147] Furthermore, common law courts, influenced by laissez-faire ideology and the practice of partnerships, did not intervene in internal governance and company matters.[148]

Despite these weak protections, Acheson et al. find that companies typically offered, by subsequent and modern-day standards, lots of protection to shareholders in their articles of association.[149] Over time, however, many of these protections offered by firms were gradually embedded into stock exchange listing requirements and subsequent iterations of the Companies Act in 1900, 1948, 1985, and 2006. Thus, stock exchanges played an important role in protecting investors and increasing information disclosure to investors.[150] Notably, stock exchanges and their listing

[140] Directors' Remuneration: Report of a Study Group, chaired by Sir Richard Greenbury, 17 July 1995.

[141] Competition on its own cannot resolve the agency problem: see Hart, 'Market mechanism'; Jensen, 'Agency costs'.

[142] See Crafts, 'Long-run growth', p. 17; Hannah, *Corporate economy*, p. 13.

[143] Campbell and Turner, 'Substitutes for legal protection'.

[144] Crafts, 'British relative economic decline'.

[145] Broadberry and Crafts, 'Britain's productivity gap'; eisdem, 'Competition and innovation'.

[146] Company Clauses Consolidation Act, 1845 - 8&9 Vict. c.16. See Foreman-Peck and Hannah, 'UK corporate law', for a discussion on the protection offered by the CCCA.

[147] Campbell and Turner, 'Substitutes for legal protection'; Acheson et al., 'Private contracting'; Cheffins, *Corporate ownership*, p. 39; Franks et al., 'Ownership'.

[148] Emden, *Shareholders' legal guide*, pp. 77–80; Jefferys, *Business organisation*, p. 394.

[149] Acheson et al., 'Private contracting'.

[150] Hannah, 'Pioneering'; Fjesme et al., 'An efficient market'.

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requirements also played a useful role in screening out low-quality applicants at the turn of the twentieth century.[151]

IV | CONCLUSIONS AND FUTURE RESEARCH

Adam Smith posed the question that ultimately determines the success or otherwise of a company: how do we get its managers to act in the interests of owners? Over the past three centuries in the United Kingdoom the solution to this problem has gradually changed. The United Kingdom has moved from a situation where the responsibility for solving the problem rested on shareholders relying on stable dividend payments, local knowledge, and delegated monitors to one where there is greater public disclosure, enhanced shareholder protection, liquid share markets, and a reliance on the market for corporate control. This raises the question as to why this change has happened. The growth in firm size, politics, global competition, the democratization of share ownership, and the move of institutional investors into shares have all played a role in shaping this change. Then, there is the question as to whether the change in corporate governance has been good for the British economy. CEO pay divorced from that of ordinary workers, perennial corporate scandals, and a sluggish new issue market perhaps suggest that all is not well with the United Kingdom's corporate economy.

Throughout this article, I have highlighted areas that are understudied. However, there is one additional area that scholars should investigate and that has been relatively neglected by economic historians. The creation of the company and the separation of ownership and control places a lot of power into the hands of one person. This individual has had many names over time: governor, chairman, managing director, or, more recently, chief executive officer (CEO). There is a recognition among contemporary scholars that CEOs in the United States have a sizeable effect upon companies and that this CEO effect has increased over time.[152] This means that future research needs to address the following questions. How did this role evolve over time? How did CEOs get to the top job? How did they perform when they got there? Did they matter for company performance, and has this changed since 1720?[153]

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DATA AVAILABILITY STATEMENT

The data in the article is already in the public domain because it is a surveys and speculations article.

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[151] Fjesme et al., 'Rejected'; 'Informed investors'.

[152] Quigley and Hambrick, 'Has the "CEO effect" increased'.

[153] For initial answers to some of these questions, see Aldous et al., 'Was Marshall right' and Adams et al., 'Aristocratic amateurs to fat cats'.

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